

ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeals of --)
)
Raytheon Company) ASBCA Nos. 57576, 57679, 58290
)
Under Contract Nos. FA8807-06-C-0004)
N00019-06-C-0310)

APPEARANCES FOR THE APPELLANT:

Paul E. Pompeo, Esq.
Lauren J. Schlanger, Esq.
Arnold & Porter LLP
Washington, DC

APPEARANCES FOR THE GOVERNMENT:

E. Michael Chiaparas, Esq.
DCMA Chief Trial Attorney
Kathleen P. Malone, Esq.
Stephen R. Dooley, Esq.
Alexander M. Healy, Esq.
Trial Attorneys
Defense Contract Management Agency
Boston, MA

OPINION BY ADMINISTRATIVE JUDGE DELMAN
ON CROSS-MOTIONS FOR SUMMARY JUDGMENT

In these appeals Raytheon Company (Raytheon or appellant)¹ disputes the government's monetary claims for Cost Accounting Standards (CAS) and Federal Acquisition Regulation (FAR) violations. Under ASBCA No. 57576, the government contends that Raytheon failed to identify and exclude from its cost submissions the costs of bonus and incentive compensation (BAIC) for those persons engaged in activities that generate unallowable costs under the following cost principles: FAR 31.205-1, -22, -27, and -47, and that are "expressly unallowable" under these principles.² Under ASBCA Nos. 57679 and 58290, the government contends that Raytheon failed to identify and exclude from its cost submissions the costs of certain stock awards to employees under its long-term performance plan (LTPP) that are "expressly unallowable" under

¹ These appeals relate to the practices of Raytheon's corporate home office.

² In *Raytheon Company*, ASBCA Nos. 57576, 57679, 13 BCA ¶ 35,209, we held that under ASBCA No. 57576, the government's claim for increased costs and penalty for CY 2002 was untimely; the government's claim for increased costs and penalty for CY 2003 was untimely; and the government's claim for increased costs for CY 2004 was untimely.

FAR 31.205-6(i). Both parties have filed motions for summary judgment, each contending that it is entitled to judgment as a matter of law. Except as provided herein, we have jurisdiction under the Contract Disputes Act (CDA), 41 U.S.C. §§ 7101-7109.³

RELEVANT STATUTES, COST ACCOUNTING STANDARDS, REGULATIONS
AND COST PRINCIPLES FOR ALL APPEALS

1. Pursuant to 41 U.S.C. § 1502(f), as implemented by FAR regulation and contract clause (e.g., FAR 52.230-2), the government may recover a contract price adjustment with interest for increased costs paid by the government due to a contractor's failure to comply with applicable cost accounting standards.

2. Insofar as pertinent, CAS 405 provides as follows:

9904.405 Accounting for unallowable costs.

....

9904.405-20 Purpose.

(a) The purpose of this Cost Accounting Standard is to facilitate the negotiation, audit, administration and settlement of contracts by establishing guidelines covering:

(1) Identification of costs specifically described as unallowable, at the time such costs first become defined or authoritatively designated as unallowable, and

(2) The cost accounting treatment to be accorded such identified unallowable costs in order to promote the consistent application of sound cost accounting principles covering all incurred costs....

....

³ Appellant's motion for summary judgment also contends that the government did not properly assert a claim under the CDA that BAIC costs paid to persons engaged in Contribution type activity, FAR 31.205-8, were expressly unallowable, and therefore the Board is without jurisdiction over this portion of the government's claim (mot. at 50-53).

9904.405-30 Definitions.

(a) The following are definitions of terms which are prominent in this Standard. Other terms defined elsewhere in this part 99 shall have the meanings ascribed to them in those definitions unless paragraph (b) of this subsection, requires otherwise.

(1) *Directly associated cost* means any cost which is generated solely as a result of the incurrence of another cost, and which would not have been incurred had the other cost not been incurred.

(2) ***Expressly unallowable cost* means a particular item or type of cost which, under the express provisions of an applicable law, regulation, or contract, is specifically named and stated to be unallowable.**

....

(4) *Unallowable cost* means any cost which, under the provisions of any pertinent law, regulation, or contract, cannot be included in prices, cost reimbursements, or settlements under a Government contract to which it is allocable.

....

9904.405-40 Fundamental requirement.

(a) **Costs expressly unallowable or mutually agreed to be unallowable, including costs mutually agreed to be unallowable directly associated costs, shall be identified and excluded from any billing, claim, or proposal applicable to a Government contract.**
[Emphasis added]

3. With respect to “expressly unallowable” costs, the CAS 405 Preamble states, in pertinent part, as follows:

The Board, in its definition of an “**expressly unallowable cost**” has used the word “expressly” in the broad dictionary sense—that which is in **direct or unmistakable terms**.
[Emphasis added]

38 Fed. Reg. 24195-97 (Sept. 6, 1973).

4. Insofar as pertinent, FAR 31.001 states as follows:

31.001 Definitions.

As used in this part—

....

“Compensation for personal services” means all remuneration paid currently or accrued, in whatever form and whether paid immediately or deferred, for services rendered by employees to the contractor.

....

“**Expressly unallowable cost**” means a particular item or type of cost which under the express provisions of an applicable law, regulation, or contract, **is specifically named and stated to be unallowable.** [Emphasis added]

5. FAR 31.201-6 implements CAS 405 as follows:

31.201-6 Accounting for unallowable costs.

(a) **Costs that are expressly unallowable** or mutually agreed to be unallowable, including mutually agreed to be unallowable directly associated costs, shall be identified and excluded from any billing, claim, or proposal applicable to a Government contract. **A directly associated cost is any cost that is generated solely as a result of incurring another cost, and that would not have been incurred had the other cost not been incurred. When an unallowable cost is incurred, its directly associated costs are also unallowable.** [Emphasis added]

....

(c)(1) The practices for accounting for and presentation of unallowable costs must be those described in 48 CFR 9904.405, Accounting for Unallowable Costs.

....

(e)(1) In determining the materiality of a directly associated cost, consideration should be given to the significance of

(i) the actual dollar amount,

(ii) the cumulative effect of all directly associated costs in a cost pool, and

(iii) the ultimate effect on the cost of Government contracts.

(2) Salary expenses of employees who participate in activities that generate unallowable costs shall be treated as directly associated costs to the extent of the time spent on the proscribed activity, provided the costs are material in accordance with subparagraph (e)(1) above (except when such salary expenses are, themselves, unallowable). The time spent in proscribed activities should be compared to total time spent on company activities to determine if the costs are material.

6. Title 10 U.S.C. § 2324 provides for assessment of penalty against contractors under certain circumstances. Subsection (b) provides, in pertinent part, as follows:

§ 2324. Allowable costs under defense contracts

....

(b) Penalty for violation of cost principle.—(1)
If the head of the agency determines that a cost submitted by a contractor in its proposal for settlement is **expressly unallowable** under a cost principle referred to in subsection (a) that defines the allowability of specific selected costs, the head of the agency shall assess a penalty against the contractor in an amount equal to—

(A) the amount of the disallowed cost allocated to covered contracts for which a proposal for settlement of indirect costs has been submitted; plus

(B) interest (to be computed based on provisions in the Federal Acquisition Regulation) to compensate the United States for the use of any funds which a contractor has been paid in excess of the amount to which the contractor was entitled. [Emphasis added]

7. FAR 42.709 implements 10 U.S.C. § 2324 as follows:

42.709 Scope.

(a) This section implements 10 U.S.C. 2324(a) through (d) and 41 U.S.C. 256(a) through (d). It covers the assessment of penalties against contractors which include unallowable indirect costs in—

- (1) Final indirect cost rate proposals; or
- (2) The final statement of costs incurred or estimated to be incurred under a fixed-price incentive contract.

(b) This section applies to all contracts in excess of \$550,000, except fixed-price contracts without cost incentives or any firm-fixed-price contracts for the purchase of commercial items.

42.709-1 General.

(a) The following penalties apply to contracts covered by this section:

(1) If the indirect cost is expressly unallowable under a cost principle in the FAR, or an executive agency supplement to the FAR, that defines the allowability of specific selected costs, the penalty is equal to—

(i) The amount of the disallowed costs allocated to contracts that are subject to this section for which an indirect cost proposal has been submitted; plus

(ii) Interest on the paid portion, if any, of the disallowance.

....

42.709-3 Assessing the penalty.

Unless a waiver is granted pursuant to 42.709-5, the cognizant contracting officer shall—

(a) Assess the penalty in 42.709-1(a)(1), when the submitted cost is **expressly unallowable** under a cost principle in the FAR or an executive agency supplement that defines the allowability of specific selected costs....
[Emphasis added]

8. The FAR cost principles related to the government's monetary claim herein include the following:

31.204 Application of principles and procedures.

....

(d) ...When more than one subsection in 31.205 is relevant to a contractor cost, the cost shall be apportioned among the applicable subsections, and the determination of allowability of each portion shall be based on the guidance contained in the applicable subsection. When a cost, to which more than one subsection in 31.205 is relevant, cannot be apportioned, the determination of allowability shall be based on the guidance contained in the subsection that most specifically deals with, or best captures the essential nature of, the cost at issue.

....

31.205-1 Public relations and advertising costs.

....

(c) Public relations and advertising costs include the costs of media time and space, purchased services performed by outside organizations, as well as **the applicable portion of salaries, travel, and fringe benefits of employees engaged in the functions and activities identified in paragraphs (a) and (b) of this subsection.** [Emphasis added]

....

(f) Unallowable public relations and advertising costs include the following:

(1) All public relations and advertising costs, other than those specified in paragraphs (d) and (e) of this subsection, whose primary purpose is to promote the sale of products or services by stimulating interest in a product or product line (except for those costs made allowable under 31.205-38(b)(5), or by disseminating messages calling favorable attention to the contractor for purposes of enhancing the company image to sell the company's products or services.

....

31.205-6 Compensation for personal services.

(a) *General.* Compensation for personal services is allowable subject to the following general criteria and additional requirements contained in other parts of this cost principle:

....

(5) Costs that are unallowable under other paragraphs of this Subpart 31.2 are not allowable under this subsection 31.205-6 solely on the basis that they constitute compensation for personal services.
[Emphasis added]

....

(f) *Bonuses and incentive compensation.* (1)
Bonuses and incentive compensation are allowable provided the—

(i) Awards are paid or accrued under an agreement entered into in good faith between the contractor and the employees before the services are rendered or pursuant to an established plan or policy followed by the contractor so consistently as to imply, in effect, an agreement to make such payment; and

(ii) Basis for the award is supported.

(2) When the bonus and incentive compensation payments are deferred, the costs are subject to the requirements of paragraphs (f)(1) and (k) of this subsection.

....

(i) *Compensation based on changes in the prices of corporate securities or corporate security ownership, such as stock options, stock appreciation rights, phantom stock plans, and junior stock conversions.*

(1) Any compensation which is calculated, or valued, based on changes in the price of corporate securities is unallowable. [Emphasis added]

(2) Any compensation represented by dividend payments or which is calculated based on dividend payments is unallowable.

....

(m) *Fringe benefits.* (1) Fringe benefits are allowances and services provided by the contractor to its employees as compensation in addition to regular wages and salaries. Fringe benefits include, but are not limited to, the cost of vacations, sick leave, holidays, military leave, employee insurance, and supplemental unemployment benefit plans....

....

31.205-22 Lobbying and political activity costs.

(a) Costs associated with the following activities are unallowable [emphasis added]:

(1) Attempts to influence the outcomes of any Federal State, or local election, referendum, initiative, or similar procedure,...

(2) Establishing, administering, contributing to, or paying the expenses of a political party, campaign, political

action committee, or other organization established for the purpose of influencing the outcomes of elections;

(3) Any attempt to influence—

(i) The introduction of Federal, state, or local legislation; or

(ii) The enactment or modification of any pending Federal, state, or local legislation through communication with any member or employee of the Congress or state legislature (including efforts to influence state or local officials to engage in similar lobbying activity), or with any government official or employee in connection with a decision to sign or veto enrolled legislation;

(4) Any attempt to influence—

(i) The introduction of Federal, state, or local legislation; or

(ii) The enactment or modification of any pending Federal, state, or local legislation by preparing, distributing or using publicity or propaganda, or by urging members of the general public or any segment thereof to contribute to or participate in any mass demonstration, march, rally, fund raising drive, lobbying campaign or letter writing or telephone campaign;

(5) Legislative liaison activities,...

(6) Costs incurred in attempting to improperly influence (see 3.401), either directly or indirectly, an employee or officer of the Executive branch of the Federal Government to give consideration to or act regarding a regulatory or contract matter.

....

31.205-27 Organization costs.

(a) Except as provided in paragraph (b) of this subsection, **expenditures in connection with** [emphasis added]—

(1) planning or executing the organization or reorganization of the corporate structure of a business, including mergers and acquisitions,

(2) resisting or planning to resist the reorganization of the corporate structure of a business or a change in the controlling interest in the ownership of a business, and—

(3) raising capital (net worth plus long term liabilities), are unallowable. Such expenditures include but are not limited to incorporation fees and costs of attorneys accountants, brokers, promoters and organizers, management consultants and investment counselors, whether or not employees of the contractor. Unallowable “reorganization” costs include the cost of any change in the contractor’s financial structure, excluding administrative costs of short-term borrowings for working capital, resulting in alterations in the rights and interests of security holders, whether or not additional capital is raised.

9. With respect to unallowable costs incurred in certain legal proceedings, 10 U.S.C. § 2324(k)(6)(B) provides as follows:

(k) Proceeding costs not allowable.—

....

(6) In this subsection:

....

(B) The term “costs”, with respect to a proceeding—

(i) means **all costs incurred by a contractor**, whether before or after the commencement of any such proceeding; and

(ii) includes—

(I) administrative and clerical expenses;

(II) the cost of legal services, including legal services performed by an employee of the contractor;

(III) the cost of the services of accountants and consultants retained by the contractor; and

(IV) **the pay of directors, officers, and employees of the contractor for time devoted by such directors, officers, and employees to such proceeding.**
[Emphasis added]

10. Insofar as pertinent, FAR 31.205-47 implements the above statute as follows:

31.205-47 Costs related to legal and other proceedings.

(a) *Definitions.* As used in this subpart—

“Costs” include, but are not limited to, administrative and clerical expenses; the costs of legal services, whether performed by in-house or private counsel; the costs of the services of accountants, consultants, or others retained by the contractor to assist it; **costs of employees, officers, and directors;** and any similar costs incurred before, during, and after commencement of a judicial or administrative proceeding which bears a direct relationship to the proceeding.
[Emphasis added]

ASBCA No. 57576

STATEMENT OF FACTS (SOF) FOR PURPOSES OF THE CROSS-MOTIONS

11. Insofar as pertinent, Raytheon’s incentive compensation plans include the “performance sharing program” (PS or PSP), the “results-based incentives” (RBI) program, the restricted stock award program and the long-term performance plan (LTPP), formerly known as the long term achievement plan (LTAP) (app. mot., ex. 1 at 3). Costs under the LTPP are at issue in ASBCA Nos. 57679 and 59290.

12. According to the government, the primary purpose behind granting of BAIC to employees is to reward employees for doing their jobs well, which would include activities that generate unallowable costs (gov’t opp’n and cross-mot. at 35-50). According to Raytheon, BAIC is granted for many reasons, including the need to retain employees and to reward them for overall company performance through achievement of defined metrics (app. reply and opp’n at 15-16.).

13. The PSP is an annual cash incentive program. Raytheon employees who are eligible for and enrolled in the PSP generally include employees whose business or location participate and who are not participating in another program, such as the RBI program or a sales incentive or similar program, unless specifically allowed by the terms of that plan. (App. mot., ex. 4 at 4412) (Statement of Uncontroverted Material Facts (SUMF), ¶¶ 2, 4)

14. Raytheon's RBI program is an annual cash incentive program for corporate employees at senior and executive levels. Participation in the program generally is limited to employees in certain pay grades, though Raytheon's senior management may approve other key contributors for participation based upon their impact to Raytheon's business. (App. mot., ex. 5, Raytheon Policy No. 0211-RP, ¶ 5.2 at 2813 (Jan. 23, 2009)).

15. On 27 March 1991, Raytheon established a stock plan to govern the award of restricted stock units to company employees (app. mot., ex. 7). On 30 November 1992, Raytheon and the government executed an Advance Agreement on the Allowability of Costs of Raytheon Company Restricted Stock Awards under which the government agreed to "recognize as allowable cost[s] the restricted stock awards made in 1991 and subsequent awards made from the Plan from time to time" (ASBCA No. 57576 (57576), app. supp. R4, tab 201 at 2).

16. On 6 March 2000, Raytheon provided a briefing to the DCAA on Raytheon's "Total Compensation Program," which discussed the company's different bonus compensation plans, including the RBI program, the PS program and the LTPP (app. mot., ex. 3).

17. By memorandum dated 14 December 2000 to the government's Defense Corporate Executive (DCE), the Defense Contract Audit Agency (DCAA) provided comments and recommendations regarding the allowability and reasonableness of a revision to Raytheon's bonus incentive plans for CY 2000. DCAA stated: "[I]f Raytheon provides an award in excess of the maximum award amount, it would not be in compliance with their established policy and these additional costs would be considered unallowable per FAR 31.205-6(f)." (App. mot., ex. 12 at 53217)

18. Effective 1 February 2001, Raytheon established its 2001 Stock Plan "to encourage ownership of Stock by key employees...and to provide additional incentive for them to promote the success of the Company's business" (57576, app. supp. R4, tab 202, Art. II, ¶ 2). On 30 April 2002, Raytheon and the government executed a memorandum of understanding regarding allocation methodology, continuing the allocation methodology under the 1992 Advance Agreement (57576, app. supp. R4, tab 203).

19. By report dated 27 September 2002, DCAA issued an audit report regarding Raytheon's proposed CY 2000 RBI/PS enhancement. The report stated "The purpose of

our engagement was to provide comments and recommendations regarding the overall allowability and reasonableness of the enhancement plan for government costing purposes.” (App. mot., ex. 13 at 4731) The DCAA report concluded: “[W]e take no exception to the CY 2000 RBI/PS enhancement costs paid to segments” (*id.* at 4732).

20. By memorandum for the record dated 29 September 2003, the DCAA reported on its audit of appellant’s CY 2002 bonus costs, specifically, the award of RBI/PS payments to Administrative and Services (A&S) employees for CY 2002. Insofar as pertinent, the memorandum stated as follows:

We examined and verified that the corporate office met the criteria set forth in the CY 2002 RBI and PS bonus plans. We reconciled with the claimed amounts to the books and records. Additionally, we verified the initial and actual targets approved by the Management Development and Compensation Committee (MDCC) Board of Directors (BOD) and verified metric computations based on actual targets achieved. The costs are determined to be allowable per FAR 31.205-6(f), Bonuses and incentive compensation.

(App. mot., ex. 14 at 7862)

21. The DCAA also audited Raytheon’s CY 2003 RBI and PS bonus payments to A&S employees. By memorandum for record dated 29 September 2004, DCAA concluded, similar to the above, as follows:

We examined and verified that the corporate office met the criteria set forth in the CY 2003 RBI and PS bonus plans. We reconciled the claimed amount to the books and records. Additionally, we verified the initial and actual targets approved by the Management Development and Compensation Committee (MDCC) of the Board of Directors (BOD) and verified metric computations based on actual targets achieved. The costs are determined to be allowable per FAR 31.205-6(f), Bonuses and Incentive Compensation.

(App. mot., ex. 15 at 10769)

22. The DCAA also audited Raytheon’s CY 2004 RBI and PS bonus payments to A&S employees. By memorandum for record, dated 30 January 2006, the DCAA provided as follows:

We examined requested support for the \$27,582,167 RBI and PS bonus expenses paid out for CY 2004 for A&S. Auditor met with contractor representative Mr. Charles Vilandre to reconcile the claimed amount to the books and records. We verified that what was paid out did not exceed what was authorized by the Management Development and Compensation Committee of the Board of Directors. No exceptions were noted.

In addition, no examination was deemed necessary regarding Other Incentive Awards as the costs were similar to prior years and overall considered to be immaterial.

(App. mot., ex. 16 at 17079)

23. In May 2004, Raytheon submitted to the government a forward pricing rate brochure (FPRB) for years 2004 through 2008 that, *inter alia*, included Raytheon's proposed annual restricted stock plan for the "Home Office Allocation" (i.e., the corporate office) as an expense for cost accounting years 2004 through 2008, which brochure was updated on 22 September 2004. The DCAA examined and issued audit reports on both submissions. With respect to the May submission, by audit report dated 23 August 2004, the DCAA questioned certain costs but otherwise concluded: "[W]e consider the forecast to be acceptable as a basis for negotiation of forward pricing rates" (ASBCA No. 58290 (58290), app. supp. R4, tab 205 at 17213). With respect to the September update, by audit report dated 7 January 2005 the DCAA also questioned certain costs but otherwise concluded: "The proposal is acceptable for negotiation of a fair and reasonable price" (*id.*, tab 206 at 18010).

24. On 19 July 2004, the DCAA issued an audit report on Raytheon's long-term incentive compensation plans. This examination was undertaken "to assure that Raytheon's Long-Term Incentive Plans are reasonable, compliant with applicable laws and regulations, and that the proposed Long-Term Incentive Plan costs are acceptable as a basis to negotiate a fair and reasonable contract price." (58290, app. supp. R4, tab 203 at 1) The audit report concluded that "[T]he Long-Term Incentive Plan compensation system and related internal control policies and procedures of the contractor are adequate" (*id.* at 2).

25. On 28 February 2005, the DCAA issued an audit report of Raytheon's CY 2003 overheard cost submission (app. mot., ex. 17). The DCAA concluded that, except for specific objections noted in the audit report not relevant here, "the contractor's proposed indirect costs are acceptable as adjusted by our examination" (*id.* at 8798).

The Government Asserts Noncompliance with CAS 405

26. By email dated 30 November 2006, a government auditor informed Raytheon “that Bonus and Restricted Stock awards are compensation/fringe type costs and that these type of costs (like at the Raytheon segments) should be proportionately withdrawn along with unallowable labor” (57576, R4, tab 3).

27. On 24 September 2007, the DCAA issued an audit report relating to CYs 2002-2005 that stated that appellant’s failure to withdraw from its incurred cost submissions a proportionate share of its costs of bonuses, restricted stock, and other compensation costs paid to employees engaged in “expressly unallowable activities” under FAR 31.205-1, Public relations and advertising costs; FAR 31.205-22, Lobbying and political activity costs; FAR 31.205-27, Organization costs; and FAR 31.205-47, Costs related to legal and other proceedings, was a violation of FAR 31.201-6(a) and CAS 405.40(a) (57576, R4, tab 8 at G-41-44).

28. By email to DCMA on 2 January 2008, Raytheon advised the government as follows:

[T]he Company is already withdrawing approximately 19% of cost center 90206 as part of the routine Lobbying withdrawal.... [T]he Company withdraws a portion of all expenses in that cost center as mutually agreed unallowable directly associated costs. This is done as a specific calculation relating to the activities in that department as a whole and is not related to an incentive compensation analysis.

(Gov’t mot., ex. 21)

29. On 30 May 2008, the corporate administrative contracting officer (CACO) issued to appellant an initial determination of noncompliance (IDN) under CAS 405 for CYs 2002-2005, and requested a formal response. The CACO stated as follows:

You may consider this letter to be notice of my initial finding of noncompliance with CAS 405-40(a) and FAR 31.201-6(a) with respect to its treatment of certain compensation costs for employees engaged in expressly unallowable activities. Raytheon failed to withdraw bonus, restricted stock, and other incentive compensation for employees engaged in expressly unallowable activities from its incurred cost submissions. CAS 405-40(a) and FAR 31.201-6(a) state in part that “Costs that are expressly unallowable...shall be identified and excluded from any

billing, claim, or proposal applicable to a government contract.”

Raytheon Company, Corporate Home Office, withdraws labor and a portion of fringe expenses for employees engaged in expressly unallowable advertising, lobbying, organization, and legal activities. However, they do not withdraw the applicable portion of bonus, restricted stock, and other incentive compensation in connection with these expressly unallowable activities.

(57576, R4, tab 11 at G-97)

30. On 10 June 2008, the DCAA issued an audit report on appellant’s CY 2006 incurred cost submission, concluding that Raytheon was noncompliant with CAS 405-40(a) and FAR 31.201-6(a) for the same reasons stated above (57576, R4, tab 12). On 27 June 2008, the CACO amended the IDN to include CY 2006 amounts (57576, R4, tab 13).

31. By letter dated 14 May 2010, the CACO issued to Raytheon a final determination of noncompliance (FDN) under CAS 405-40(a). This notice, in pertinent part, provided as follows:

Based on my review of the foregoing mentioned information, I find that Raytheon Company, Corporate Home Office, is in noncompliance with CAS 405-40(a) with respect to its treatment of certain compensation costs for employees engaged in expressly unallowable activities. This estimating and accumulating noncompliance impacts all CAS-covered (both Fixed Price and Flexibly Priced) contracts and subcontracts for the period of 2002 through 2008. Accordingly, and as required by FAR 30.605(c), you are requested to provide a general dollar magnitude (GDM) proposal within 60 days of this letter. The GDM proposal shall be calculated in accordance with paragraph (d) of this section. In addition, if you have additional information which has not been considered relative to this issue, you may provide it.

(57576, R4, tab 15 at G-130) Raytheon responded by letter dated 2 July 2010, expressing disagreement with the CACO’s conclusions (57576, R4, tab 16).

32. In response to the CACO’s request for a GDM proposal, Raytheon by letter dated 1 October 2010, submitted a proposal to the government, using what it called the

“fringe delta” method. Under the “fringe delta” method Raytheon recalculated the standard fringe benefit, using not only the fringe benefits costs paid to employees engaged in the unallowable activities in question, but also including bonus and incentive compensation costs. The result was a higher fringe benefit rate. The difference between Raytheon’s standard fringe benefit rate and the higher recalculated fringe benefit rate was what Raytheon called the “fringe delta.” This fringe delta was then multiplied by each employee’s charges for the year (labor rate multiplied by labor hours charged). (SUMF ¶ 110; 57576, R4, tab 17 at G-141)

33. The government was of the opinion that appellant’s “fringe delta” computation was not a proper GDM proposal for CAS purposes, and requested that Raytheon submit an alternative calculation. In response, Raytheon submitted a calculation using the “discrete” method of computation. Under this method, for each employee engaged in the “unallowable activity” during the relevant time period, Raytheon identified the percentage of that employee’s time dedicated to the aforementioned activities. Raytheon multiplied the amount of that employee’s bonuses and incentive compensation by the percentage of that employee’s time dedicated to the “unallowable activity” to arrive at the final calculation. (SUMF ¶ 112)

34. In preparing its calculations, Raytheon submitted data from the four Raytheon cost centers applicable to the four FAR cost principles the government cited in its FDN: (i) Advertising & Public Relations; (ii) Lobbying/Government Relations/PAC; (iii) Strategic/Business Development; and (iv) Legal. However, Raytheon also included in its calculations a fifth cost center related to activities for community relations and charitable donations (Contributions). The Contributions cost center, 90054, is part of the “Corporate Affairs and Communications” cost group that also includes the cost for advertising and public relations. (SUMF ¶¶ 113-14)

35. The unallowability of BAIC costs in connection with persons engaged in activities related to Contributions, *see* FAR 31.205-8, was not mentioned in the DCAA reports or in the government’s IDN or FDN.

36. On 10 January 2011, the CACO issued a final decision (COFD), citing the DCAA reports and finding that Raytheon was noncompliant with CAS 405-40(a) because it did not withdraw/exclude the costs of BAIC awards paid to corporate employees engaged in activities under FAR 31.205-1, FAR 31.205-22, FAR 31.205-27, and FAR 31.205-47. The COFD stated that these BAIC costs were “expressly unallowable” under these four cost principles, and that noncompliance resulted in the payment of increased costs by the government on CAS-covered, fixed-price and flexibly-priced contracts during the CY 2002 through 2009 cost accounting periods, using two such representative contracts for this purpose. (57576, R4, tab 20 at G-149)

37. Using the “discrete” quantum methodology that Raytheon provided, which included costs from the Contributions center, the CACO identified \$11,176,482 as the total amount of bonus and incentive compensation costs not withdrawn/excluded from Raytheon’s CAS-covered, fixed-price and flexibly-priced contracts during the CY 2002 through 2009 cost accounting periods (57576, R4, tab 20, attach. I, table B).

38. In the COFD, the CACO did not assert that appellant failed to exclude BAIC costs for those engaged in activities under FAR 31.205-8, Contributions. The only mention of “contributions” is in attachment I, “TABLE A: INCENTIVE COMPENSATION NOT WITHDRAWN AS EXPRESSLY UNALLOWABLE UNDER FAR 31.205-1, FAR 31.205-22, FAR 31.205-27 AND FAR 31.205-47” wherein one quantum element is labeled “contributions” (57576, R4, tab 20, attach. I, table A).

39. The COFD also included interest on the increased costs claimed, in the amount of \$2,889,334, for a total claimed equitable adjustment of \$14,065,816 (57576, R4, tab 20). In addition, the COFD demanded a penalty under FAR 42.709 and under contract clause FAR 52.242-3, Penalties for Unallowable Costs, in the amount of \$5,030,543, and added simple interest in the amount of \$916,219 in accordance with FAR 52.242-3(d)(2). The COFD demanded the total sum of \$20,012,578. (*Id.* at G-152, attach. II at G-157)

40. Raytheon timely appealed the COFD to this Board. The appeal was docketed under ASBCA No. 57576.

DECISION
ASBCA No. 57576

Jurisdiction

Raytheon contends that the government has not asserted a claim against it for the failure to exclude BAIC costs for those persons engaged in activities to support the administration of corporate contributions, FAR 31.205-8, and hence the Board has no jurisdiction over this matter.

It is well settled that a condition precedent to our jurisdiction under the CDA is the assertion of a proper claim by one of the contracting parties. When the claimant is the contractor, the claim must be submitted to the CO for decision. 41 U.S.C. § 7103(a)(1). When the claimant is the government, as is the case here, the CO must assert the claim in the form of a final decision issued to the contractor. 41 U.S.C. § 7103(a)(3). A claimant must provide adequate notice of the basis and amount of its claim. *H.L. Smith, Inc. v. Dalton*, 49 F.3d 1563, 1565 (Fed. Cir. 1995); *Contract Cleaning Maintenance, Inc. v. United States*, 811 F.2d 586, 592 (Fed. Cir. 1987).

We have reviewed the COFD, the document that asserted the government's claim here. The body of the COFD asserted claims for increased costs paid by the government attributable to appellant's failure to exclude BAIC costs paid to those persons engaged in activities under FAR 31.205-1, -22, -27, -47. It did not assert any claim for increased costs paid by the government attributable to appellant's failure to exclude BAIC costs paid to those persons engaged in activities under FAR 31.205-8, nor did it mention anything about the BAIC costs of employees engaged in the activities of corporate contributions. Nor was this purported "claim" mentioned in the IDN or FDN.

According to the government, it included these costs in its COFD quantum computation because appellant's cost impact analysis included these costs. Appellant contends that this inclusion was "inadvertent"; the government contends the inclusion was "deliberate." However, this dispute has no bearing on the jurisdictional issue. In the final analysis, the record shows that the government did not assert, and provide adequate notice of a claim for exclusion of BAIC costs for those persons engaged in "Contributions" type activities under FAR 31.205-8. Since the government failed to properly assert this claim against Raytheon, it must be eliminated from the government's quantum calculation in the COFD.

Consistent with the foregoing, ASBCA No. 57576 is dismissed, in part, for lack of jurisdiction.

Guiding Legal Principles

Both parties have filed motions for summary judgment. It is well settled that in order to obtain summary judgment, a party must show there are no material facts in dispute and that it is entitled to judgment as a matter of law. *Mingus Constructors, Inc. v. United States*, 812 F.2d 1387, 1390 (Fed. Cir. 1987). All reasonable factual inferences must be drawn in favor of the nonmoving party. *M. Maropakis Carpentry, Inc. v. United States*, 609 F.3d 1323, 1327 (Fed. Cir. 2010). Our task is not to weigh competing evidence and resolve disputes, but only to determine whether disputed material facts exist. *John C. Grimberg Co.*, ASBCA No. 51693, 99-2 BCA ¶ 30,572 at 150,969.

Whether interpreting statutes, CAS or procurement regulations, we seek an interpretation consistent with the plain terms provided; it is not our prerogative to insert additional words or phrases to alter an otherwise plain and clear meaning. *Tesoro Hawaii Corp. v. United States*, 405 F.3d 1339, 1346 (Fed. Cir. 2005). *Northrop Grumman Corp.*, ASBCA No. 57625, 14-1 BCA ¶ 35,501, *recon. denied*, 14-1 BCA ¶ 35,743. A party's use of unpublished material to support interpretation is not relevant: "The CAS standards, like any other regulation, must be interpreted based on public authorities." *Sikorsky Aircraft Corp. v. United States*, 773 F.3d 1315, 1323 (Fed. Cir. 2014). The government has the burden to show CAS noncompliance. *Id.*

The government also has the burden to show that costs are unallowable. *Parsons-UXB Joint Venture*, ASBCA No. 56481, 13 BCA ¶ 35,378 at 173,598.

Whether BAIC Cost is “Expressly Unallowable” Under the Cost Principles

FAR 31.205-1

An “expressly unallowable” cost, by the plain terms of the definition, must be an item of cost or a type of cost that is specifically named and stated as unallowable by law, regulation or contract (SOF ¶ 2). BAIC cost is an item or type of cost, but it is not specifically named and stated as unallowable under FAR 31.205-1. While portions of “salaries” and “fringe benefits” are stated as unallowable under this cost principle, the government, as claimant, has not shown that BAIC constitutes either one. BAIC and salary are different types of compensation. Salary is fixed compensation. *See* NEW OXFORD AMERICAN DICTIONARY (3d ed. 2010) (salary is “a fixed regular payment, typically paid on a monthly or biweekly basis but often expressed as an annual sum”). BAIC, indisputably, is not fixed compensation. Also, under FAR 31.205-6, Compensation for personal services, “salary” and “bonuses” are identified as different types of compensation. *See* FAR 31.205-6(p)(2)(i) (“*Compensation* means the total amount of **wages, salary, bonuses, deferred compensation...**”) (emphasis added). Nor has the government shown that BAIC cost constitutes “fringe benefits.” According to FAR 31.205-6(m)(1): “Fringe benefits are allowances and services provided by the contractor to its employees as compensation in addition to regular wages and salaries” (SOF ¶ 8). BAIC cost is not an allowance or a service. BAIC and fringe benefits are also addressed separately by the Compensation cost principle. *Compare* FAR 31.205-6(f) and FAR 31.205-6(m) (SOF ¶ 8).⁴

We believe that appellant’s BAIC costs are not expressly unallowable under this cost principle. Accordingly, the government has not established a violation of CAS 405 and has not established its entitlement to a penalty for the failure to exclude “expressly unallowable” costs. We grant summary judgment to appellant on this issue.

FAR 31.205-22

This cost principle makes unallowable these costs “associated with” certain lobbying and political activity. Neither “BAIC” cost nor “compensation” cost is specifically named and stated as unallowable under this cost principle, nor are such costs identified as unallowable in any direct or unmistakable terms.

⁴ In a letter to the government, Raytheon once characterized BAIC cost as a “fringe benefit” type of cost (57576, R4, tab 14 at 123), but such a characterization does not trump the plain language of FAR 31.205-6(m)(1).

In support of its position under this lobbying principle, the government cites to an email from Raytheon to DCMA dated 2 January 2008, and related deposition testimony, stating that for CY 2005 Raytheon withdrew “a portion of all expenses in that cost center [Cong. Affairs 90206] as mutually agreed unallowable directly associated costs,” of which BAIC cost apparently was a part (SOF ¶ 28). However, we believe that Raytheon’s treatment of these costs, for whatever reason, cannot negate the clear language of CAS 405 and the implementing regulations that guide us in determining whether costs are expressly unallowable under a cost principle.

We conclude that appellant’s BAIC costs for those persons engaged in this activity are not expressly unallowable under FAR 31.205-22. Accordingly, the government has not established a violation of CAS 405 and has not established its entitlement to a penalty for failure to exclude expressly unallowable costs. We grant summary judgment to appellant on this issue.

FAR 31.205-27

Similar to FAR 31.205-22, this cost principle renders unallowable those costs “in connection with” certain organization-type activity. Our conclusion is also the same. Neither “BAIC” cost nor “compensation” cost is specifically named and stated as unallowable under this regulation, nor are these costs otherwise identified in any direct or unmistakable terms.

We conclude that appellant’s BAIC costs for those persons engaged in this activity are not expressly unallowable under this cost principle. Accordingly, the government has not established a violation of CAS 405, and has not established entitlement to a penalty for failure to exclude expressly unallowable costs. We grant summary judgment to appellant on this issue.

FAR 31.205-47

Subsection (k) of 10 U.S.C. § 2324, which was added as a result of the Major Fraud Act of 1988, Pub. L. No. 100-700, 102 Stat. 4636, provides, at subsection (k)(6)(B), that unallowable costs—relating to the legal proceedings defined by the clause—mean “**all costs incurred by a contractor,**” including “**the pay of directors, officers, and employees**” for the time devoted to the questioned proceeding (emphasis added) (SOF ¶ 9). Clearly, BAIC costs are “pay” type costs under this definition.

The FAR interim rule, implementing this statutory change, gave expression to this Congressional mandate by rendering unallowable “all elements of compensation, related costs and expenses of employees, officers and directors.” FAC 84-44, Item III, 54 Fed. Reg. 13022. The final FAR rule, with which we deal here, more generally rendered unallowable the “costs of employees, officers and directors.” FAC 90-3, Item 25, 55 Fed. Reg. 52782, 52794. In explanation of the final rule, the FAR framers

stated: “The definition of costs in the interim rule at 31.205-47(a) has been clarified to describe only general categories of costs, rather than particular types of costs within the category.” (*Id.*) There is nothing in these remarks or otherwise in the record to suggest that the FAR framers intended to retreat from the broadly defined cost exclusions of the interim FAR rule, or to otherwise limit the broadly defined cost exclusions in the statute.

Given the plain wording of the statute and the implementing regulatory cost principle, it is unreasonable under all circumstances to conclude that appellant’s BAIC costs with respect to the defined proceedings are allowable. *See General Dynamics Corp.*, ASBCA No. 49372, 02-2 BCA ¶ 31,888 at 157,570.

There can be no question that the plain and unequivocal language of the statute, as implemented by FAR 31.205-47, trumps the general allowability provision of FAR 31.205-6(f). Nor do Raytheon’s arguments of “internal government debate” over the allowability of these BAIC costs, and of the views of a different CACO *vis-a-vis* another defense contractor (app. mot. at 41-50) serve to negate this plain meaning.

Under CAS 405(a)(2) an “expressly unallowable” cost is a “particular item or type of cost” that is “specifically named and stated to be unallowable” under the “express provisions of law, regulation or contract.” We have carefully considered all of appellant’s arguments, but we believe Raytheon’s bonus and incentive compensation costs are a type of cost (a “pay” cost) that is specifically named and stated to be unallowable under the express provisions of law and regulation. These costs are “expressly unallowable” costs. We grant summary judgment to the government on entitlement on this issue.⁵

Whether BAIC Cost is Otherwise Unallowable Under the Cost Principles

FAR 31.205-1

FAR 31.205-1(f)(1) identifies unallowable “public relations and advertising costs,” but that term is further defined in FAR 31.205-1(c). Insofar as pertinent, FAR 31.205-1(c) defines “public relations and advertising costs,” as including the applicable portion of “salaries” and “fringe benefits” of those employees engaged in the functions and activities identified in paragraphs (a) and (b) of the cost principle.

Notably, the cost principle does not use the term “BAIC” cost or the broader term “compensation”, which would include BAIC cost. *See* FAR 31.001. The framers of the cost principles were presumably well aware of the concept of “compensation” and its various components. *See generally* FAR 31.205-6. If they wished to render

⁵ With respect to the government’s recovery of its damages, *see* “Appellant’s Defenses” *infra*.

unallowable the applicable portion of any “compensation” here they could have said so. Indeed, they did say so in other contexts. See FAR 31.205-6(i) (“*Compensation based on changes in the prices of corporate securities...*”; also subsection FAR 31.205-6(i)(1) “*Any compensation...*”) (emphasis added) (SOF ¶ 8). They did not say so here.

We must presume that the FAR framers’ choice of language when addressing unallowable labor cost under this cost principle was knowing and deliberate. With respect to the terms they did use—“salaries” and “fringe benefits”—the government has not shown that BAIC cost is equivalent to, or subsumed under either.

However, these BAIC costs may be unallowable on another basis, that is, as a “directly associated cost” (DAC) to unallowable salary cost. See FAR 31.201-6(a) (when unallowable cost incurred, its DAC also unallowable) (SOF ¶ 5). Under this provision, a DAC is a cost “generated solely as a result” of another cost and “would not have been incurred had the other cost not been incurred” (*id.*). Whether appellant’s BAIC costs meet these requirements, however, is a material, factual dispute between the parties (SOF ¶ 12).

Based upon the foregoing, we do not grant summary judgment to either party regarding the allowability of appellant’s BAIC costs for those engaged in unallowable cost activity under FAR 31.205-1.

FAR 31.205-22

We believe appellant’s BAIC costs of those engaged in lobbying activities under FAR 31.205-22(a) are unallowable under this cost principle.

Under FAR 31.205-22(a), this cost principle broadly makes unallowable the costs “associated with” certain lobbying and political activity. It is self-evident that a basic element of a contractor’s lobbying costs is the compensation paid to those who perform lobbying activities. Such compensation is reasonably “associated with” lobbying activity so as to be unallowable under this cost principle. This includes BAIC cost.

Raytheon argues that based upon FAR 31.204(d), we must defer to FAR 31.205-6(f), the subsection that most specifically deals with the allowability of BAIC costs and under which appellant’s BAIC costs are allowable (SOF ¶ 8). We do not agree. Appellant fails to read, and give reasonable meaning to FAR 31.205-6 in its entirety. FAR 31.205-6(a), *General*, states that “Compensation for personal services is allowable **subject to the following general criteria and additional requirements contained in other parts of the cost principle.**” One such criterion and requirement is found in FAR 31.205-6(a)(5), stating that “Costs that are **unallowable under other paragraphs of this Subpart 31.2** are not allowable under this subsection 31.205-6 solely on the basis that they constitute compensation for personal services.” (SOF ¶ 8)

(Emphasis added) We believe FAR 31.205-22 is one such paragraph under Subpart 31.2.

We believe appellant's BAIC costs attributable to employees engaged in lobbying activities under FAR 31.205-22(a) are unallowable. We grant summary judgment on entitlement to the government on this issue.

FAR 31.205-27

We believe appellant's BAIC costs attributable to employees engaged in organization-type activities under FAR 31.205-27(a) are unallowable.

Under FAR 31.205-27(a), this cost principle broadly makes unallowable contractor "expenditures in connection with" certain organization-type activity. As above, we believe that a basic element of a contractor's organization-type activity cost is the compensation paid to those who perform these activities. Such compensation is reasonably "in connection with" this activity so as to be unallowable under this cost principle. This includes BAIC cost.

In addition, subsection (a)(3) of this cost principle renders unallowable a contractor's costs of personnel, such as attorneys, accountants, etc., performing the defined activities "**whether or not employees of the contractor.**" A contractor's costs of such employees reasonably include the compensation costs of these employees.

For reasons stated herein and above, appellant's BAIC costs attributable to employees engaged in organization-type activities under FAR 31.205-27(a) are unallowable. We grant summary judgment to the government on entitlement on this issue.

ASBCA Nos. 57679, 58290

STATEMENT OF FACTS (SOF) FOR PURPOSES OF THE CROSS-MOTIONS

41. Raytheon's LTPP is a form of deferred compensation and is a component of Raytheon's 2001 Stock Plan. Raytheon adopted the LTPP in 2003. Participation in the LTPP is limited to key business leaders nominated annually by Raytheon's senior management. (SUMF ¶¶ 41-43)

42. Insofar as pertinent to these appeals, under the LTPP Raytheon granted a target number of stock shares to LTPP participants at the beginning of a three-year performance cycle. Participants could earn shares in addition to those granted based upon achievement of specified levels of company performance, or metrics, over this three-year period. Conversely, participants would not earn the shares initially granted to them in the event these metrics were not achieved. (SUMF ¶¶ 44-46)

43. For the three-year performance cycle beginning in 2004, appellant's metrics were known as "Free Cash Flow" (FCF) and "Total Shareholder Return" (TSR) (SUMF ¶ 124). The government's claim under these appeals refers to the TSR metric only.

44. Under the TSR metric, Raytheon compared the compounded annual return of its shareholders to the compounded annual return of the shareholders of each of ten Raytheon competitors. In the LTPP cycles that are the subject of these appeals, i.e., 2004-2006, 2005-2007, 2006-2008, and 2007-2009, Raytheon employed the following formula to calculate the TSR metric for Raytheon and as well as the TSR metric for each of these ten peer companies:

$$\frac{\text{Ending Stock Price} + 3 \text{ Years Dividends}}{\text{Beginning Stock Price}}$$

(SUMF ¶¶ 126-27)

45. Raytheon ranked its calculated TSR metric with the calculated TSR metric of each of its ten competitors, i.e., Raytheon could be ranked anywhere from #1 to #11 in this ranking. Generally, the higher Raytheon's ranking within the group, the larger the share award multiplier that was attached to that ranking. (SUMF ¶¶ 129-30)

46. In December 2003 and January 2004, Raytheon briefed the government with respect to the LTPP. Insofar as pertinent, the December 2003 briefing charts provided as follows:

Long-term Performance Plan

Key Aspects

- **3-year performance goals will be established at beginning of each 3-year performance cycle**

[REDACTED REDACTED REDACTED REDACTED REDACTED REDACTED REDACTED REDACTED REDACTED REDACTED] based on total shareholder return (TSR) versus peers [Footnote omitted]

- **Actual number of shares earned and awarded dependent on degree of performance goal attainment**

[REDACTED REDACTED REDACTED REDACTED REDACTED REDACTED REDACTED REDACTED REDACTED REDACTED]

REDACTED REDACTED REDACTED REDACTED
REDACTED]

- **Performance cycles overlap as a new 3-year cycle is initiated each year**

(App. mot., ex. 11) It appears that these charts did not contain the TSR formula above.

47. The January 2004 briefing chart was similar in all material respects to the above chart (58290, app. supp. R4, tab 200). The government did not express an opinion as to the allowability of the costs generated by the TSR metric at or around this time.

48. In 2004, the DCAA audited Raytheon's LTPP. The government auditor was of the view that appellant's costs for share awards arising from the TSR metric were allowable under FAR 31.205-6(i). Her opinion was documented in an audit work paper in part as follows:

[T]he LTPP costs are allowable because the shares granted are based on the stock price versus the company's peers and not strictly on the change [sic] stock price. ... [S]ince the grant of LTPP shares is not dependent on a change in price of Raytheon stock, the amount is allowable.

(App. mot., ex. 44 at G-55) The record does not show that Raytheon was privy to this work paper at or around the time it was prepared, or that Raytheon was otherwise advised in writing of this auditor's opinion.

49. The audit report issued as a result of this audit work, dated 19 July 2004, concluded that Raytheon's "long-term incentive plan compensation system and related internal control policies and procedures of the contractor are adequate" (58290, app. supp. R4, tab 203 at 2). The audit report did not expressly allow the awarded share costs resulting from the TSR metric calculation, nor does it appear that the audit report mentioned this metric at all.

50. By Supplemental Report on Audit of CY 2006 Incurred Costs, dated 27 June 2008, the DCAA questioned costs of restricted stock due to noncompliance with CAS 415 (not CAS 405) and FAR 31.205-6(i) "because future payments cannot be measured with reasonable accuracy" (57679, R4, tab 1, at 2). Insofar as pertinent here, the DCAA also concluded that "costs incurred for the TSR metric of Raytheon's LTPP are not allowable per FAR 31.205-6(i) because the number of shares awarded is dependent on the change in the price of Raytheon's stock." The report also noted: "The questioned cost is not subject to penalty." (*Id.* at 22)

51. On 17 July 2008, DCAA issued an audit report reiterating its conclusion that Raytheon's accounting for LTPP costs violated CAS 415 on the ground that the amount of future payments could not be measured with reasonable accuracy (57679, R4, tab 2 at 2). The CACO subsequently issued an FDN under CAS 415 (57679, R4, tab 5), but later determined that the cost impact of the violation was immaterial (57679, R4, tab 7). Insofar as pertinent here, this audit report also stated that appellant's TSR-related costs were unallowable per FAR 31.205-6(i) "because the number of shares awarded is dependent on the change in the price of Raytheon stock" (57679, R4, tab 2 at 6).

52. The government did not issue an IDN or FDN with respect to CAS 405 at this time.

53. By letter to Raytheon dated 2 June 2011, the CACO issued a COFD, asserting that the costs of the TSR portion of Raytheon's LTPP were expressly unallowable under FAR 31.205-6(i) because the TSR formula "shows that the stock award to a TSR participant is arrived at by determining the change in stock price" (57679, R4, tab 8 at 2-3). Insofar as pertinent, the CACO asserted a claim under the Allowable Cost clause of a representative contract to recover the expressly unallowable costs for CYs 2004-2006 in the amount of \$1,316,183, plus penalty and interest, for a total of \$2,993,127. The CACO did not assert a claim for payment or for compound interest under CAS 405.⁶ In addition, the CACO asserted a claim for expressly unallowable "dividend equivalent" costs for CYs 2005-2006, plus penalty and interest, in the amount of \$662,922. (*Id.* at 5)

54. Raytheon timely appealed this COFD by notice of appeal dated 7 July 2011. Raytheon appealed the COFD decision as it pertained to the TSR claim; it did not appeal the decision as it pertained to the government's "dividend equivalent" claim. The appeal was docketed as ASBCA No. 57679.

55. On 13 February 2012, pursuant to FAR 30.605(b), the CACO issued an IDN under CAS 405, stating that the "costs of the Total Shareholder Return (TSR) portion of the LTPP are expressly unallowable under FAR Subpart 31.205-6(i)(1) because they are based on changes in the price of corporate securities" (58290, R4, tab 8).

56. On 25 May 2012 the CACO issued a second COFD, which questioned the TSR metric portion of appellant's share costs from Raytheon's 2005-2007, 2006-2008, and 2007-2009 LTPPs that had been included in the company's CY 2005-2009 incurred cost proposals, and added penalties and interest under FAR 42.709, demanding a total of

⁶ In its explanation to the Board, the government stated that because this COFD "does not identify CAS 405 as the basis of the government's monetary claim' the Government is not currently seeking CAS damages for this final decision alone" (jt. resp. to Bd. order dtd. 25 January 2015 at 6).

\$3,397,537. This COFD determined that the TSR costs were expressly unallowable, were subject to penalty and were in noncompliance with CAS 405. (58290, R4, tab 10 at 1, 2, 6)

57. Raytheon timely appealed this decision. The appeal was docketed as ASBCA No. 58290, and was consolidated with ASBCA Nos. 57576 and 57679.

DECISION
ASBCA Nos. 57679, 58290

It is undisputed that under the LTPP for purposes of granting share awards, Raytheon used the following formula to generate a “TSR metric” figure for Raytheon and for each of ten peer companies:

$$\frac{\text{Ending Stock Price} + 3 \text{ Year Dividends}}{\text{Beginning Stock Price}}$$

Raytheon ranked its calculated Total Shareholder Return/TSR metric with the calculated TSR metric of each of the ten peer companies; generally, a higher Raytheon ranking among the group resulted in the award of additional shares to its employees; a lower relative ranking resulted in the award of fewer shares.

The plain language of the cost principle, FAR 31.205-6(i), provides that “any compensation” that is “calculated” or “valued” based upon “changes in the price of corporate securities” is unallowable (SOF ¶ 8). Appellant’s LTPP share awards are a type of “compensation.” This compensation is calculated or valued based upon “changes in the price of corporate securities” through use of the above formula and the respective rankings related thereto. Accordingly, we believe this type of compensation is specifically named and stated as unallowable under the express provisions of this cost principle.

Appellant argues, however, that it had reasonable grounds to believe that these costs were allowable. For example, appellant contends that FAR 31.205-6(i) does not expressly list “TSR” as an example of the type of compensation it purports to identify as unallowable (app. mot. at 58). However, subsection (i), is entitled in part: “*Compensation based on changes in the prices of corporate securities,*” and the TSR metric calculation clearly and unmistakably falls into that category. That the caption of the cost principle goes on to give examples of such plans does not limit the regulation to the examples provided.

Appellant also tenders as support for its position the opinion of a DCAA auditor who opined in an audit work paper that these share award costs were allowable under FAR 31.205-6(i) (SOF ¶ 48). However, we are unaware of any audit report,

memorandum or other writing of record sent to appellant at or around that time that substantiates this auditor's opinion. We also believe the auditor misread the cost principle. Contrary to the auditor's opinion, in order to be unallowable the award of shares need not be solely dependent upon the change in price of Raytheon stock (SOF ¶ 48). Rather, the plain language of the cost principle more broadly renders unallowable any compensation that is "calculated" or "valued" based upon "changes in the price of corporate securities." The subject compensation clearly and expressly falls under this proscription.

Appellant also points to the government's failure to tell Raytheon that it believed the TSR would generate unallowable costs after being briefed on the new program in late 2003 and early 2004 (mot. at 69; SOF ¶ 46). However, the government was under no legal obligation to advise Raytheon of its position at such a briefing. That the government failed to "get back" to Raytheon on the matter was not an admission of allowability, nor a reasonable basis for appellant to conclude that the costs would be viewed as allowable in the future.

Appellant also offers up evidence of internal debate amongst government personnel with respect to the allowability of these costs, e.g., "[T]here was repeated consultation and conversation and consternation" (mot. at 65). However, such extrinsic evidence cannot trump the plain language of the cost principle.

We have reviewed all of appellant's contentions, but believe there can be no reasonable difference of opinion regarding these TSR costs. We believe it would be unreasonable under all circumstances to conclude that these costs were allowable. *See General Dynamics*, 02-2 BCA ¶ 31,888 at 157,570.

For reasons stated, we believe that appellant's TSR share award costs under the LTPP constitute compensation costs that are "expressly unallowable" under FAR 31.205-6(i). Accordingly, we sustain the government's claim on entitlement under the COFD dated 2 June 2011 and the COFD dated 25 May 2012 (*see* n.5 regarding first COFD). We grant the government summary judgment on entitlement on these claims.⁷

Appellant's Defenses

Raytheon contends, citing *Litton Systems, Inc. v. United States*, 449 F.2d 392 (Ct. Cl. 1971), that the government is barred as a matter of law from recovering any costs/damages on its claims. According to appellant, given the government's consistent approval of and/or acquiescence to the subject BAIC and TSR metric costs, it was barred from disallowing those costs prior to the issuance of an authoritative notice that such

⁷ With respect to whether the government may recover its damages, *see Appellant's Defenses, infra*.

costs were no longer allowable. Appellant posits that the government's 2011 final decisions on the BAIC costs (SOF ¶ 36) and TSR costs (SOF ¶ 53) were the first such government notices, and hence any costs incurred prior to these dates are not recoverable.

The above principle is commonly known as the "retroactive disallowance" principle. The government does not dispute the principle, but contends that it has no bearing on the government's monetary claims under the facts of record.

We have applied the retroactive disallowance principle to bar recovery of government claims. *Lockheed Martin Western Development Laboratories*, ASBCA No. 51452, 02-1 BCA ¶ 31,803. However, its application is largely fact-dependent. In these appeals, there are material factual disputes of record that need to be addressed to determine whether this principle is applicable here, including but not limited to, whether or not the government, with knowledge, consistently approved the subject BAIC and TSR metric costs; and if so, when the government first put appellant on reasonable notice that said costs were unallowable. Given these material fact disputes, we decline to award summary judgment to either party on this defense. *See Peat, Marwick, Mitchell & Co.*, ASBCA No. 29847, 86-2 BCA ¶ 18,915 at 95,400.⁸

To the extent appellant also invokes equitable estoppel principles against the government here, we recently set out the test to prove equitable estoppel against the government in *Northrop Grumman*, 14-1 BCA ¶ 35,501 at 174,023, *recon. denied.*, 14-1 BCA ¶ 35,743:

Equitable estoppel requires a showing of: 1) misleading conduct leading another to reasonably infer that rights will not be asserted against it; 2) reliance on this conduct; and 3) material prejudice as a result of this reliance. *When estoppel is asserted against the government, a showing of affirmative misconduct is required in addition to these elements.* [Citations omitted]

We further held that this added requirement of affirmative misconduct contemplates government misconduct "of a nature more compelling than the conduct that would otherwise apply against a private party. *See, e.g., RGW Communications*, 05-2 BCA 32,972 at 163,336 (referencing deliberate lies; a pattern of false promises, or

⁸ Since we decline to award summary judgment to either party on appellant's defense, there is no reason to discuss quantum at this time, assuming, *arguendo*, that the Board decides to hear quantum. We also note that the parties dispute the proper calculation of quantum including, but not limited to, the extent to which certain fixed-price contracts should be considered in determining cost impact for any CAS violation.

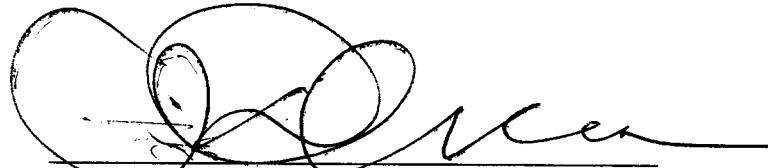
intentional deception as examples of affirmative misconduct).” *Northrop Grumman*, 14-1 BCA ¶ 35,501 at 174,024.

Based upon the foregoing, we believe that Raytheon has failed to adduce any evidence to support a finding of affirmative misconduct by the government here. Hence, Raytheon has failed to adduce evidence necessary to support its estoppel defense as a matter of law. We grant summary judgment to the government on appellant’s defense of equitable estoppel.

CONCLUSION

The parties’ motions for summary judgment are granted in part and denied in part consistent with this opinion. Under ASBCA No. 57576, the appeal is dismissed, in part, for lack of jurisdiction consistent with this opinion.

Dated: 26 June 2015



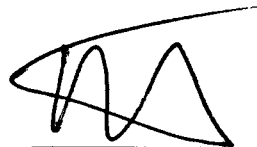
JACK DELMAN
Administrative Judge
Armed Services Board
of Contract Appeals

I concur



MARK N. STEMPLER
Administrative Judge
Acting Chairman
Armed Services Board
of Contract Appeals

I concur



RICHARD SHACKLEFORD
Administrative Judge
Vice Chairman
Armed Services Board
of Contract Appeals

I certify that the foregoing is a true copy of the Opinion and Decision of the Armed Services Board of Contract Appeals in ASBCA Nos. 57576, 57679, 58290, Appeals of Raytheon Company, rendered in conformance with the Board's Charter.

Dated:

JEFFREY D. GARDIN
Recorder, Armed Services
Board of Contract Appeals